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In the Supreme Court of the United States

OCTOBER TERM, 1945

WALTER J. ROTHENSIES, INDIVIDUALLY, AND AS UNITED STATES COLLECTOR OF INTERNAL REVENUE FOR THE FIRST DISTRICT OF PENNSYLVANIA, PETITIONER

v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

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v.

THE ELECTRIC STORAGE BATTERY COMPANY, A CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

The Solicitor General, on behalf of Walter J. Rothensies, individually, and as United States Collector of Internal Revenue for the First District of Pennsylvania, prays that a writ of certiorari issue to review the judgment of the United States Circuit Court of Appeals for the Third Circuit, entered November 27, 1945, affirming the judgment of the District Court of the United States for the Eastern District of Pennsylvania.

OPINIONS BELOW

The opinion of the District Court (R. 5a) is reported in 57 F. Supp. 731. The opinion of the Circuit Court of Appeals (R. 2) is not yet reported.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on November 27, 1945. (R. 9.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The taxpayer in 1935 received a refund of excise taxes for periods from July 1922 to April 1926, and thereafter paid income taxes for the year 1935 with respect to that refund. Those income taxes were held herein to have been properly imposed. Nevertheless, the courts below awarded the taxpayer a refund of those 1935 income taxes from the Collector of Internal Revenue to whom they were paid, on the ground that similar excise taxes which the taxpayer had erroneously paid to predecessor Collectors for periods between 1919 and 1922 (the refund of which had been barred by limitations) should have been offset against the 1935 income taxes on the principle of recoupment. The questions presented are:

(1) Whether equitable principles of recoupment are applicable.

(2) Whether in any event Sections 608–610 of the Revenue Act of 1928 preclude a recoupment of the barred excise taxes.

(3) Whether in this suit against the Collector for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to this Collector's predecessors in office.

STATUTES INVOLVED

The pertinent provisions of the statutes involved are set out in the Appendix, *infra*, pp. 14–17.

STATEMENT

The facts as stipulated (R. 18a–21a; T. 51–86)[1] and as found by the District Court (R. 17a; T. 87–99, 114) may be summarized as follows:

During the period between April 28, 1919, and June 27, 1922, inclusive, the taxpayer paid excise taxes on sales of storage batteries, of which amounts the sum of $95,098.06 was subsequently refunded, leaving a net amount of $912,978.57 for which no claim for refund was ever filed or allowed (R. 18a, 19a). The excise taxes so paid were taken as deductions by the taxpayer in its federal income tax returns for the years 1919 to 1922, inclusive, and through the deduction thereof tax-

[1] For purposes of the petition for certiorari, an abbreviated record, consisting of the printed record below plus the proceedings in the court below, has been filed. The reference "R." is to the printed record; the reference "T." is to volume 1 of the typewritten transcript on file in the Court.

payer secured a substantial tax benefit. (R. 20a.) During such period the taxpayer made monthly returns of excise taxes in which it reported sales of its storage batteries and it paid such excise taxes to the then Collectors of Internal Revenue for the First District of Pennsylvania, who were the predecessors in office of the Collector named in this suit. (R. 18a.)

During the period between July 1922, and April 1926, inclusive, the taxpayer paid excise taxes in the amount of $825,151.52 on sales of storage batteries (T. 52–53), which excise taxes were taken as deductions in the taxpayer's income tax returns for the years 1922 to 1926, inclusive, and so resulted in a tax benefit to it of $139,668.83, exclusive of interest, or the sum of $305,335.07, including interest to June 5, 1944 (T. 54). On July 19, 1926, the taxpayer filed a timely claim for refund of the excise taxes paid in the amount of $825,151.52 for the period between 1922 and 1926. (T. 55.) Following the rejection of its claim for refund, the taxpayer instituted suit in the United States District Court for the Eastern District of Pennsylvania against the then Collector of Internal Revenue, and secured a judgment in that court for a refund of $1,416,567.81, and in 1933 the Circuit Court of Appeals for the Third Circuit affirmed the judgment. (T. 55–57.) The Government subsequently declined to pay the judgment on the ground that the taxpayer had not established that it had borne the burden of the

tax, and that under the decision in the case of *Routzahn* v. *Willard Storage Battery Co.*, 291 U. S. 386, no recovery was allowable. (T. 57–58.) However, after prolonged negotiations the taxpayer agreed in 1935 to accept the payment of $1,395,515.35 of which $825,151.52 represented tax, and the balance represented interest. (T. 58.) In its income tax return for the year 1935 the taxpayer reported as income only the portion of the interest accrued on the refund of excise taxes during the year 1935. (T. 58–59.) The Commissioner of Internal Revenue held that the refund of tax in the amount of $825,151.52 and the whole amount of interest thereon was taxable as income for the year 1935 and accordingly assessed an additional income and excess profits tax against the taxpayer for that year, which, together with interest, amounted to $229,805.34. (T. 59.) After payment of such income and excess profits tax deficiency, together with interest, the taxpayer filed a timely claim for refund thereof, and upon the rejection of its claim, this suit was instituted. (T. 60.) The taxpayer contended in its claim for refund and in its suit that the amounts added by the Commissioner to its taxable income for the year 1935 were not income at all and if they were, it could not be taxed therefor in the year 1935; and, in the alternative, it maintained that if the assessment of the additional taxes for the year 1935 was correct, then it should be permitted to recoup the amount of the excise taxes collected

from it between 1919 and 1922. (T. 69–84; T. 3–12.)

The District Court held that the deficiency in 1935 income and excess profits tax was properly assessed and collected, but that the taxpayer had a right to recoupment equal to the amount of the excise taxes collected from it between 1919 and 1922, less the tax benefit derived from the deduction of such excise taxes in its income tax returns for the years 1919 to 1922, inclusive, including interest. Accordingly, the District Court rendered judgment for the amount sued for plus interest. (R. 4a–17a.)

The Circuit Court of Appeals affirmed the judgment of the District Court, agreeing with that court that the deficiency in 1935 income and excess profits tax was properly assessed but that the taxpayer had a right to recoup the barred excise taxes for the years 1919 to 1922. (R. 2–10.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

(1) In holding that, in the suit for refund of income taxes for 1935 properly imposed upon a refund of excise taxes erroneously paid on sales of storage batteries, the taxpayer may recoup excise taxes erroneously paid in earlier periods on other sales of storage batteries, the refund of which is barred by the statute of limitations.

(2) In holding that excise taxes erroneously paid on sales of storage batteries over the periods from 1919 to 1922 arose out of the same transaction within the principle of recoupment as income taxes imposed on the refund of similar excise taxes erroneously paid for later years.

(3) In holding that the limitations in the Revenue Act of 1928 are applicable only to the Government and do not preclude the taxpayer from recouping the barred excise taxes in the suit for refund of income taxes.

(4) In holding that the right to recoupment is a substantive right which vested in the taxpayer when the excise taxes were paid in the years 1919 to 1922, and that Sections 608 and 609 should not be interpreted to cut off this right.

(5) In holding that, in the suit against a Collector of Internal Revenue for refund of income taxes paid to such Collector, the taxpayer may recoup excise taxes paid to that Collector's predecessors in office.

(6) In affirming the judgment of the District Court.

REASONS FOR GRANTING THE WRIT

1. The question of the scope of the principle of recoupment in suits for the recovery of federal taxes arises frequently and considerable confusion and a certain amount of basic inconsis-

tency now exist among the decisions.[2] It would be in the public interest to have the matter clarified. The decision of the court below in the present case is believed to be incorrect and to create additional and undesirable uncertainties in this field.

A large portion of the present confusion is due to the difficulties in reconciling and applying the decisions of this Court in *Bull* v. *United States*, 295 U. S. 247, and *Stone* v. *White*, 301 U. S. 532, rehearing denied, 302 U. S. 777, on the one hand, and *McEachern* v. *Rose*, 302 U. S. 56, on the other.

In the present case, the court below held that the recoupment doctrine announced in the *Bull* case was applicable, although stating that the main claim and the recoupment claim were more closely connected in the *Bull* case than they are here.[3]

The decision below in this respect constitutes an unwarranted extension of the principle of the

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[2] In the opinion of the dissenting judge in *American Light & Traction Co.* v. *Harrison*, 142 F. 2d 639, 644 (C. C. A. 7th), it is said: "The situation as it now exists, is vexatious, perplexing, and confusing." See also The Doctrine of Recoupment in Federal Taxation, 28 Va. L. Rev. 577 (1941–1942); and notes in 109 A. L. R. 1354, 130 A. L. R. 838 and 154 A. L. R. 1052.

[3] The court below relies also upon *Dixie Margarine Co.* v. *Commissioner*, 115 F. 2d 445 (C. C. A. 6th). That was an appeal from the Board of Tax Appeals. In *Commissioner* v. *Gooch Co.*, 320 U. S. 418, this Court held that the Board had no jurisdiction to consider defenses based upon recoupment.

Bull case. Under the *Bull* decision, a recoupment claim, to be sustained, must arise out of some feature of the transaction upon which the main action is grounded. Here the main action was for income taxes for the year 1935, held by the court below to have been properly imposed. It is true that these income taxes were imposed upon a refund of excise taxes, but the excise taxes refunded were for the periods between 1922 and 1926. During those four years the taxpayer had secured a tax benefit, by virtue of deducting the excise taxes in its returns for those years, which, with interest, roughly approximated the income taxes, with interest, imposed upon the refund of the excise taxes. The income taxes imposed in 1935 related in no respect to anything which had occurred prior to June 1922.

The court below stated, however, that it saw no reason for "hedging the 'transaction' part of the requirement of the *Bull* case within close quarters, especially where * * * there is a logical connection between main claim and recoupment claim." (R. 5.) The logical connection between the main claim in the present case and the recoupment claim exists, the court held (R. 4), in the fact that the barred excise taxes for the periods from April 1919 to June 1922 sought to be recouped were the same type of tax imposed upon the same nature of merchandise sold as the excise taxes for the later periods, the subsequent refund of which gave rise to the income tax.

Concededly the taxpayer could not have joined a claim for the excise taxes for the periods from 1919 to June 1922 in the suit which it brought in 1928 against the then Collector of Internal Revenue for refund of the excise taxes for the periods from June 1922 to February 1926, because even in 1928 suit for the earlier years was barred through failure to file a timely claim for refund for those years. By sustaining the recoupment claim in the present case, the court below has permitted the taxpayer to accomplish indirectly what it could not do directly. Indeed, there would be less excuse for permitting a recovery of the barred excise taxes for 1919 to 1922 in the present suit for income taxes for 1935 than in the earlier suit for refund of the excise taxes for 1922 to 1926, for the income taxes were imposed upon the *refund* of the excise taxes for the later years and therefore the relationship of the income tax to the excise taxes for the earlier years is one step farther removed.

We submit that the only pertinent transaction in 1935 was the refund. The recoupment claim had no relationship to the refund save the totally irrelevant fact that the refund and the recoupment claim had a common origin in excise taxes paid upon the manufacture and sale of storage batteries. But they were not even the same batteries. If the recoupment principle is to be applied to distinct transactions merely because they grow out of earlier transactions which were simi-

lar but not related, the scope of the principle is of wider compass than has been generally understood.

The radical extension by the court below of the theory of what constitutes the same transaction for recoupment purposes is of such far-reaching consequences, we submit, as to call for review by this Court.

2. In the District Court and in the court below, the Collector contended that in any event recoupment was barred by Section 608 and Section 609 (b) of the Revenue Act of 1928. (Appendix, *infra*.) The holding of the court below rejecting this contention is in direct conflict with the decisions of the Court of Claims in *Hall* v. *United States*, 43 F. Supp. 130, certiorari denied, 316 U. S. 664, and *Lynchburg Coal & Coke Co.* v. *United States*, 47 F. Supp. 916.

Under Revised Statutes, Section 3228, as amended (Appendix, *infra*), claims for refund of the excise taxes for the periods 1919 to 1922 could not have been filed later than 1926, but no claim was ever filed, and consequently, under Revised Statutes, Section 3226 (Appendix, *infra*), no suit could be maintained for such taxes. Under Sections 608 and 609 (b), a refund of those taxes, after the statute of limitations had run in 1926, would have constituted an erroneous refund which the United States could have recovered under Section 610, and a credit of the overpayment against the income taxes for 1935 would have been void.

In similar circumstances, the Court of Claims, applying the reasoning of this Court in *McEachern* v. *Rose*, 302 U. S. 56, held in the above entitled cases that recoupment was barred by Sections 608 and 609 (b).[4]

3. The holding of the court below that the taxpayer may, in the suit against Collector Rothensies, recoup taxes paid to the Collector's predecessors in office, conflicts in principle with the decision of this Court in *United States* v. *Kales*, 314 U. S. 186. In that case this Court said (pp. 199–200):

> It was payment to the collector which gave rise to the suit against him and limited the amount of the recovery. The judgment against the collector is a personal judgment, to which the United States is a stranger except as it has obligated itself to pay it. * * *
>
> * * * * * *
>
> By no possibility could the respondent in the suit brought against Collector Woodworth in 1925 recover taxes paid to Collector Grogan in 1920, which she demands here. * * *

In the present case the income taxes for 1935 which were paid to Collector Rothensies were, as held below, correctly determined and assessed

[4] In the *Hall* case, the Government filed a memorandum stating that it would welcome a reexamination of *McEachern* v. *Rose* and that it did not oppose certiorari if the writ were granted for that purpose.

against the taxpayer. The excise taxes for 1919 to 1922 sought to be recovered by way of recoupment were paid to the Collector's predecessors in office. Collector Rothensies was a stranger to the payment of the excise taxes. The effect of the decision below is to allow a personal judgment against one Collector because of payments made to another Collector.[5]

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

J. HOWARD MCGRATH,
Solicitor General.

FEBRUARY, 1946.

[5] Both in the *Kales* case and in *United States* v. *Nunnally Investment Co.*, 316 U. S. 258, the Government attacked the doctrine that a suit against the collector is "personal" today, but the Court rejected the contention. In the circumstances, the Government accepts the doctrine, which plainly forbids a refund from a collector, whether through recoupment, offset, or other procedural device, on account of taxes paid to a different collector.

APPENDIX

Revenue Act of 1928, c. 852, 45 Stat. 791:

SEC. 607. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST UNITED STATES.

Any tax (or any interest, penalty, additional amount, or addition to such tax) assessed or paid (whether before or after the enactment of this Act) after the expiration of the period of limitation properly applicable thereto shall be considered an overpayment and shall be credited or refunded to the taxpayer if claim therefor is filed within the period of limitation for filing such claim.

SEC. 608. EFFECT OF EXPIRATION OF PERIOD OF LIMITATION AGAINST TAXPAYER.[5]

A refund of any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) made after the enactment of this Act, shall be considered erroneous—

(a) if made after the expiration of the period of limitation for filing claim therefor, unless within such period claim was filed; or

(b) in the case of a claim filed within the proper time and disallowed by the Commissioner after the enactment of this Act, if the refund was made after the expiration of the period of limitation for filing suit, unless—

(1) within such period suit was begun by the taxpayer, or

[5] The last sentence of Section 608 (b) (2) of the Revenue Act of 1928 was added by Section 503 of the Revenue Act of 1934, c. 277, 48 Stat. 680.

(2) within such period, teh taxpayer and the Commissioner agreed in writing to suspend the running of the statute of limitations for filing suit from the date of the agreement to the date of final decision in one or more named cases then pending before the United States Board of Tax Appeals or the courts. If such agreement has been entered into, the running of such statute of limitations shall be suspended in accordance with the terms of the agreement.

SEC. 609. ERRONEOUS CREDITS.

(a) *Credit against barred deficiency.*—Any credit against a liability in respect of any taxable year shall be void if any payment in respect of such liability would be considered an overpayment under section 607.

(b) *Credit of barred overpayment.*—A credit of an overpayment in respect of any tax shall be void if a refund of such overpayment would be considered erroneous under section 608.

(c) *Application of section.*—The provisions of this section shall apply to any credit made before or after the enactment of this Act.

SEC. 610. RECOVERY OF AMOUNTS ERRONEOUSLY REFUNDED.

(a) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) refund of which is erroneously made, within the meaning of section 608, after the enactment of this Act, may be recovered by suit brought in the name of the United States, but only if such suit is begun within two years after the making of such refund.

(b) Any portion of an internal-revenue tax (or any interest, penalty, additional amount, or addition to such tax) which

has been erroneously refunded (if such refund would not be considered as erroneous under section 608) may be recovered by suit brought in the name of the United States, but only if such suit is begun before the expiration of two years after the making of such refund or before May 1, 1928, whichever date is later.

Revised Statutes:

SEC. 3226. No suit shall be maintained in any court for the recovery of any internal tax alleged to have been erroneously or illegally assessed or collected, or of any penalty claimed to have been collected without authority, or of any sum alleged to have been excessive or in any manner wrongfully collected, until appeal shall have been duly made to the Commissioner of [*the*] Internal Revenue, according to the provisions of law in that regard, and the regulations of the Secretary of the Treasury established in pursuance thereof, and a decision of the Commissioner has been had therein: *Provided*, That if such decision is delayed more than six months from the date of such appeal, then the said suit may be brought, without first having a decision of the Commissioner at any time within the period limited in the next section.

SEC. 3228 [as amended by the Revenue Act of 1926, c. 27, 44 Stat. 9, Sec. 1112; Revenue Act of 1928, c. 852, 45 Stat. 791, Sec. 619 (c); Revenue Act of 1932, c. 209, 47 Stat. 169, Sec. 1106 (a)]. (a) All claims for the refunding or crediting of any internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or of any penalty alleged to have been collected without authority, or of any

sum alleged to have been excessive or in any manner wrongfully collected must, except as otherwise provided by law in the case of income, war-profits, excess-profits, estate, and gift taxes, be presented to the Commissioner of Internal Revenue within four years next after the payment of such tax, penalty, or sum. The amount of the refund (in the case of taxes other than income, war-profits, excess-profits, estate, and gift taxes) shall not exceed the portion of the tax, penalty, or sum paid during the four years immediately preceding the filing of the claim, or if no claim was filed, then during the four years immediately preceding the allowance of the refund.

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